

FEDERAL ENERGY REGULATORY COMMISSION

WASHINGTON, DC 20426

OFFICE OF THE CHAIRMAN

July 31, 1998

The Honorable John D. Dingell  
Ranking Member  
Committee on Commerce  
U.S. House of Representatives  
Washington, D.C. 20515

Dear Congressman Dingell:

Thank you for your letter of July 15, 1998, regarding the volatility exhibited in recent weeks in electrical power spot energy prices in the Midwest.

Many events converged in late June to produce the abnormally high prices for short-term energy purchases by utilities. Certainly physical events such as hot weather, generation outages, and transmission constraints contributed to the situation. There may have been other contributing factors such as power portfolio choices, contracting problems, a shortage of good information, and a lack of market maturity.

Since the Midwest price spike, the Commission has been in close contact with affected utilities, state public utility commissions, the North American Electric Reliability Council (NERC) and its regional reliability councils, and various market participants in an attempt to learn more about what happened, and why.

We are all concerned that the nation's electrical power system operate in a reliable, efficient, and low cost manner, and it is for that reason I announced, on July 15, 1998, the formation of a staff fact-finding team to look into the events of June. The team will gather information and make visits to the parties in the region seeking answers to such questions as: What led to the price spikes? Did the market succeed or fail? Are the events and results likely to recur? What can we learn about emerging market structures and behaviors? At the end of this study, the Commission will have a better understanding of what occurred.

We believe our fact-finding study is the best first step in determining what happened, and until the team completes its study, I cannot provide definitive answers to some of the questions you pose. However, enclosed are our best current responses. I hope this information is helpful.

The Honorable John D. Dingell

-2-

If I can be of further assistance in this or any other Commission matter, please let me know.

Sincerely,

A handwritten signature in dark ink, appearing to read "James J. Hoecker". The signature is fluid and cursive, with a large loop at the end.

James J. Hoecker  
Chairman

Enclosure

cc: The Honorable Tom Bliley

## Responses to Questions

1. Please outline your understanding of the course of events leading to supply curtailments and price surges in electricity markets during the week of June 22, including any gaps in your understanding of relevant facts.

We do not yet have all the information about the Midwest situation. The Commission has initiated a staff fact-finding group to look into the causes of the late June price spikes in the Midwest. From what the Commission has been able to piece together so far from press reports and anecdotes, a number of physical factors came together to contribute to the markets' susceptibility to above-normal price levels during the week of June 22:

- A. Shortages of electrical generation stemming from the continuing shutdown of several large nuclear plants and the unplanned outages of several large coal-fired plants.
- B. Widespread thunderstorm and tornado activity from Minnesota to New England that knocked out many electrical generators and transmission lines, reducing both local generation capability and the transmission transfer capability needed to deliver power purchases from others.
- C. A widespread heat wave that increased the electrical loads over a large area on the remaining operating generating capacity, thus reducing the normal ability of one region to supply power to another region.

In addition, there have been reports about heavy reliance by some utilities on the nonfirm "spot" market for supplies of electricity, and power trading activities hampered by incomplete information arising from inadequate communications and market infrastructure, as well as allegations about poor business decisions and improper behavior by some market participants. Also, rumors of contract defaults and severe price shortages may have led some utilities to purchase power at extraordinary prices. There may have been a lack of market transparency that led certain market participants to overreact.

2. Are you considering initiating, or have you already begun, an inquiry into these events? If so, please describe the purposes, scope, and timetable for completion of any such proceeding.

We began informally to gather information about the events in the Midwest the day after the event. Subsequently, the Commission announced on Wednesday, July 15, 1998 that it was initiating a staff fact-finding group to look into the causes of the late June price spikes in the Midwest. The Commission hopes to learn more about the course of events, who was involved, and what the economic consequences are. We want to determine whether, if the same physical conditions were to recur, severe price spikes would happen again or whether market participants will have learned from the experience. It will take several weeks for the staff group to complete its review.

3. Are you seeking or participating in any such proceeding undertaken by another organization?

Inquiries by public utility regulators are underway in several states. We intend to coordinate our efforts with those of the affected states. As part of our fact-finding effort, we have contacted the National Association of Regulatory Utility Commissioners (NARUC) leadership to arrange a meeting with state utility commissioners from the region in the near future.

4. Do you consider the price spikes and supply shortages in the Midwest during June to be a one time event, or might they recur? Are you concerned about the remainder of the summer, and what are the factors affecting near-term market stability? If you think a recurrence of market turbulence is possible, do you believe changes in market structure or regulation may be needed?

We are very concerned about the supply situation in the Midwest and its influence on market prices for the remainder of the summer. It is possible that supply shortages can recur from various combinations of physical factors. The North American Electric Reliability Council (NERC) 1998 *Summer Assessment* reports that, even under the most optimistic scenarios, supply shortages could occur in the northern and central Illinois portion of the Mid-America Interconnected Network (MAIN) region. It is too early to tell precisely what changes in market structure or regulation are needed. This is what we are trying to ascertain in our fact-finding inquiry. This situation has already led to higher than normal prices in the Midwest several times this summer. When we complete our study we will begin to assess precisely what changes in market structure or regulation may be needed.

5. Are you aware of any complaints alleging market manipulation or conflicts of interest involving regulated utilities or other market participants?

The Commission has received at least four complaints concerning above-normal price levels experienced in the Midwest. The issues raised in these complaints include the failure of certain market participants to provide contracted electricity, the impacts of emergency actions undertaken by regional reliability councils, and the adequacy of measures available to interruptible service customers to allow them to buy power, even at high prices, despite their voluntary curtailable status.

6. What, if any, direct or indirect effects on consumers resulted, or may yet result, from the price and supply disruptions in the Midwest in late June? Are residential consumers more or less vulnerable than industrial consumers, in terms of price increase and reliability of supply?

Sales to consumers (e.g., residential, commercial, industrial customers) are regulated at the state level. The direct and indirect effects of wholesale price disruptions on such consumers depend to a large extent on each state's policies, for example, whether the state permits pass-through of purchased power costs to consumers. We understand that regulators in the affected states are looking at the effects on retail consumers. They are in a better position to examine the retail impacts on a state-by-state basis.

7. What, if any, effects did this market volatility have on public power entities and their consumers?

As part of its fact-finding inquiry, the Commission hopes to learn more about how public power entities were affected at the wholesale level. At the retail level, state and local regulators and local public officials are in the best position to determine how ultimate consumers were affected.

8. Do you foresee any lessons to be drawn from this experience for state and federal legislators deliberating the merits of electric restructuring legislation? How would more widespread retail competition affect market stability in the future, and how would residential consumers be affected? Are markets ready to make a smooth transition to full retail competition now, and should Congress pass legislation to compel states to adopt competition?

With regard to wholesale competition and Federal legislation, last fall I testified before the House Subcommittee on Energy and Power that FERC's authority over transmission should be extended to all utilities, compliance

with reliability standards should be made mandatory with Federal oversight, and our authority to establish regional transmission institutions should be further clarified. I believe that these measures are important factors to help deal with some aspects of price spike events. It is premature to draw conclusions or provide recommendations regarding retail restructuring based on these market events. It is unlikely that our fact-finding inquiry, which mostly focuses on wholesale sales, will by themselves support any firm conclusions regarding these important retail issues. Nonetheless, these recent events certainly highlight the importance of market monitoring at both the state and Federal levels and, as I mentioned above, we plan to coordinate our inquiry with state regulators.